E-015/GR-89-50VARYING RULE AND REQUIRING FILING

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of a Petition from Minnesota Power & Light Company for a Declaratory Ruling or, in the Alternative, for a Variance Regarding Certain Fuel Purchases Used for Off-System Energy Sales

ISSUE DATE: August 2, 1989

DOCKET NO. E-015/GR-89-50

ORDER VARYING RULE AND REQUIRING FILING

PROCEDURAL HISTORY

On September 27, 1988, Minnesota Power & Light Company (MP or the Company) filed a Petition for Declaratory Ruling with the Federal Energy Regulatory Commission (FERC). MP sought approval to use spot-market coal in pricing off-system energy sales, rather than blending the spot-market coal with the contract coal used for wholesale and retail customers through the fuel clause. MP asked that FERC find that the Company's accounting and rate treatment was just, reasonable and consistent with FERC's regulations and wholesale fuel adjustment clauses. MP asked that this approval apply for sales that had already been made as well as to similar future sales.

On February 2, 1989, MP filed this petition with the Minnesota Public Utilities Commission (the Commission). MP seeks a declaratory ruling similar to that in the petition filed at FERC except that it addresses the Minnesota jurisdiction, and in the alternative seeks a variance for the Commission's automatic fuel clause adjustment rules.

On February 22, 1989, Superwood Corporation (Superwood) filed a petition to intervene in this matter and a request for hearing; MP responded on March 1, 1989.

On March 3, 1989, the Commission solicited comments on MP's and Superwood's filings. Comments were due on March 24, 1989 with no replies accepted. The notice was sent to the service list of the Company's most recent general rate case, Docket No. E-015/GR-87-223.

On March 23, 1989, the Department of Public Service (Department or DPS) filed comments recommending that the Commission approve the variance.

On March 24, 1989, Superwood filed comments opposing MP's petition. Hibbing Taconite Joint Venture, Inland Steel Mining Company, National Steel Pellet Company, USX Corporation, and Eveleth Mines (Taconites) jointly filed comments supporting MP's request for a variance, but recommended that the Company be required to share the margin on the off-system sales.

On March 30, 1989, the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) filed comments recommending approval of a variance with a sharing of the profits, together with its Petition for Allowance of Late Filing.

On April 14, 1989, the Commission noticed interested persons that reply comments could be filed until April 26, 1989.

The Company, the DPS, and the RUD-OAG filed reply comments.

On April 19, 1989, the FERC issued its Order on Petition for Declaratory Order which denied MP's request.

The Commission met on June 8, 1989 to consider this matter.

FINDINGS AND CONCLUSIONS

The Commission must first decide whether to grant Superwood's petition to intervene and request for a hearing.

The Commission will grant Superwood's request to intervene. No party objected to Superwood's intervention. The Commission notes that Superwood is a major user of electricity from MP and will be affected by the decisions made here in a manner different from that of the general public.

The Commission will not, however, grant Superwood's request for a contested case hearing in this matter. There are no material facts in dispute that merit a contested case hearing here; the issues before the Commission are policy issues which are resolved without contested case proceedings.

Next, the Commission must decide whether to grant the RUD-OAG's petition for late filed comments.

The Commission had requested that comments be submitted by March 24, 1989. The RUD-OAG filed its comments on March 30, 1989, stating that it was unaware of the March 24, 1989 deadline.

The Commission will accept the RUD-OAG's late filed comments in this matter. The Commission finds that the RUD-OAG's late filing has not inconvenienced this process. All interested persons were afforded an opportunity to reply to all filed comments, including the RUD-OAG's.

BACKGROUND OF MP'S PROPOSAL

As a member of the Mid-Continent Area Power Pool (MAPP), MP has the opportunity to buy and sell energy off-system with other MAPP members. MP indicated that it has generally priced the off-system energy based on the incremental cost of producing the energy and has calculated the incremental fuel cost related to the off-system sales using the greater of the most recent three-month average LIFO delivered cost of fuel, or the average stockpile cost. MP explained that calculating the fuel cost using this pricing mechanism yields a $24.00/ton coal cost, requiring an off-system energy selling price of approximately $16.50/MWh. MP stated that currently it would be unable to make additional off-system sales since the market clearing price is approximately $15.00/MWh.

MP has a long-term coal supply contract with Peabody Coal Company. Under that contract, MP must take minimum annual deliveries of 3.15 million tons. MP has negotiated lower prices for amounts taken in excess of the 3.15 million tons. A similar situation exists for freight costs on the Burlington Northern Railroad, except that a reduction in freight rates begins for amounts in excess of 2.8 million tons. MP's coal purchases have been exceeding the minimum contract requirements.

MP stated that if coal is procured specifically for the off-system transactions at the lower negotiated price and is reflected in the off-system energy selling price, an off-system energy selling price of approximately $13.00/MWh would be required. MP stated that this would facilitate off-system sales and would benefit ratepayers in general. The lower required selling price results because applying the three-month average LIFO delivered cost, or the average stockpile cost methods allocate the lower cost coal to all production, and is passed through to ratepayers through the fuel adjustment clause. MP's proposed method would allow the lower cost coal purchased for specific off-system energy sales to be applied only to those sales and not flowed to the ratepayers through the fuel adjustment clause.

MP proposed that specifying coal for the off-system sales would involve creating two stockpiles of coal for accounting purposes, while maintaining only one physical stockpile. MP provided information detailing the arrangements and accounting related to off-system energy sales which MP recently made to the Manitoba Hydro Electric Board and to Iowa Electric Light and Power. Those sales incorporated the proposed pricing and accounting mechanisms.

MP'S PROPOSAL

MP requested that the Commission issue a declaratory order finding that MP's accounting and rate treatment of the cost-of-fuel of off-system energy sales is consistent with the Commission's rules, that MP's accounting and rate treatment of the cost-of-fuel for off-system energy sales is consistent with the fuel cost adjustment clause of MP's retail electric service rates, and MP's accounting and rate treatments of the cost-of-fuel for the off-system energy sales to Manitoba Hydro Electric Board and to Iowa Electric Light and Power Company were consistent with the Commission's rules and MP's retail fuel adjustment clause. Should the Commission decline to grant a declaratory order, MP requested that the Commission vary its automatic fuel cost adjustment rules to permit MP to use the proposed accounting and rate treatment for off-system energy sales.

The DPS recommended that a variance to the Commission's automatic fuel adjustment rules be granted, rather than a declaratory order. The DPS recommended that MP's proposal be modified to require MP to file a description of all transactions made under the variance with MP's monthly fuel adjustment filing.

The RUD-OAG and the Taconites recommended that the Commission grant a variance to the fuel adjustment rules rather than issue a declaratory order. The RUD-OAG and the Taconites recommended that 50 per cent of the profit earned by MP on the off-system sales be shared with the ratepayers through the fuel adjustment clause. The RUD-OAG also recommended that there be a reporting for monitoring purposes and that MP be allowed to apply the proposed accounting and rate treatment for those off-system sales MP would otherwise be unable to make.

Superwood recommended that MP's petition for declaratory ruling or variance be denied and that MP be ordered to refund the amount necessary to reflect the proper application of MP's retail fuel cost adjustment clause for those sales already made incorporating the proposed methods.

ISSUE

The Commission must now decide whether to grant MP's request for a declaratory ruling or variance to allow the Company to use the proposed accounting and rate treatment for off-system energy sales.

DECLARATORY RULING

The Commission will deny the Company's request for a Declaratory Order that MP's proposal and past sales made under it comply with the Commission's automatic fuel clause adjustment rules. The Commission's automatic fuel adjustment rules, Minn. Rules, part 7825.2400, subps. 8 and 9 define the cost of fuel for purposes of inclusion in the automatic fuel adjustment as all withdrawals from account 151 as defined by the Minnesota uniform system of accounts. Account 151 does not provide for the establishment of two separate accounting stockpiles of coal. The rules do not permit MP to reserve some of the lowest cost fuel for specific customers. The Commission notes that historically MP has interpreted Minn. Rules, part 7825.2400, subps. 8 and 9 to include all withdrawals from account 151, as evidenced by its pricing of the off-system sales using the greater of the most recent three-month average LIFO delivered cost of fuel, or the average stockpile cost. The Commission concludes that MP's proposal is inconsistent with the Commission's automatic fuel adjustment rules and will deny the Company's request for a Declaratory Order stating otherwise.

VARIANCE

The Commission will next address the question of a variance to Minn. Rules 7825.2400, subp. 8 and 9 to allow the segregation of specific fuel costs for specific off-system energy sales.

Minn. Rules, part 7830.4400 authorizes the Commission to grant a variance to any of its rules upon finding that the following conditions apply:

1. Enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule;

2. Granting the variance would not adversely affect the public interest; and

3. Granting the variance would not conflict with standards imposed by law.

Schedules submitted by MP indicated that, for the off-system energy sales to the Manitoba Hydro Electric Board and to Iowa Electric Light and Power, benefits of approximately $2.2 million flowed to ratepayers through the fuel adjustment clause. The Company claimed that these benefits result from improved generation efficiency due to the increased loading on MP's generating facilities, coal purchasing benefits due to the allocation of fixed costs included in the coal contract over larger quantities of coal taken, and a rebate of Montana coal severance taxes. MP reported margins to the Company of approximately $1.2 million on the off-system sales.

No party to this proceeding disputed the potential benefits to ratepayers and the Company from the

increased sales made possible by designating lower cost fuel to the specific off-system sales.

The Commission finds that enforcement of the rule would impose an excessive burden on the Company and its ratepayers. Without a variance authorizing the proposed accounting and rate treatment, MP is unlikely to be able to make additional off-system energy sales because its incremental cost may exceed the market price. The Commission finds that the inability to make additional off-system sales may be detrimental to ratepayers and the Company. The benefits of such sales are described above.

The Commission finds that a variance would not adversely affect the public interest. Rather, granting a variance has the potential of aiding MP in making cost-effective sales, and in lowering rates for MP's retail ratepayers. Significant benefits may flow to MP and the ratepayers which otherwise may be lost.

Finally, the Commission finds that a variance would not conflict with law. MP's proposal includes accounting mechanisms which are intended to identify the incremental coal costs used for the off-system sales. Monitoring, discussed below, will provide additional assurance that each transaction is in the public interest. The proposal does not discriminate against ratepayers because ratepayers will continue to pay only for fuel costs incurred in the production of energy used by the ratepayers. In cases where MP's retail customer's energy needs exceed the coal contract minimum requirements, retail ratepayers will continue to receive the lower cost coal as well.

The Commission concludes that the requirements of Minn. Rules, part 7830.4400 have been met and will vary Minn. Rules 7825.2400, subp. 8 and 9 to allow the MP's proposed accounting and rate treatment for off-system sales.

However, the Commission agrees with the DPS that the Company should report on all transactions made under this variance in its monthly fuel adjustment filing. This will allow Department and Commission review of all transactions made under this variance which will ensure that each off-system sale proposed under the variance is consistent with the goal of lowering fuel cost to ratepayers, and therefore continues to be in the public interest. The Commission will not entertain proposals which may result in the advancement of the interests of the off-system customers to the detriment of the retail ratepayers.

Also, the Commission will limit this variance to one year in keeping with past Commission practice to ensure that variances continue to be in the public interest.

SHARING OF MARGINS

Next, the Commission will address the question of whether there should be a sharing with ratepayers of the margins received by MP from the off-system sales.

The RUD-OAG and the Taconites recommended, if a variance is granted, that MP be required to make an equal sharing of any margin on the off-system sales made under the variance with ratepayers.

The DPS viewed such a sharing as a marked departure from present regulatory practice and did not recommend a sharing.

In MP's last rate case more than $4 million of margin from off-system energy sales was included in revenues. (In the Matter of the Petition of Minnesota Power and Light Company, d/b/a Minnesota Power, for Authority to Change its Schedule of Rates for Retail Electric Service in Minnesota, Docket No. E-015/GR-87-223, March 1, 1988.) As a result, present rates reflect a certain level of off-system energy margin. That level of margin will continue to be recognized until changed through a rate case or a rate investigation. When it is determined that rates no longer reflect existing conditions, a rate case or rate investigation must be started. No evidence has been presented here that suggests that the existing margins included in rates are unreasonable. Therefore, the Commission will not require a sharing of the margin as proposed by the RUD-OAG and the Taconites.

EARLIER OFF-SYSTEM ENERGY SALES

Finally, the Commission will address the question of refunds due to MP's implementation of its proposed accounting and rate treatments prior to the Commission's action today.

MP implemented its proposal with off-system energy sales to the Manitoba Hydro Electric Board and Iowa Electric Light and Power. Those sales were completed prior to MP's filing of its request for declaratory order or variance.

Superwood recommended that MP be required to refund to ratepayers the amount necessary to reflect the proper application of MP's fuel clause as was in effect at the time the sales took place.

The Commission finds that the record is insufficient to decide this issue. The Commission will require MP to file additional information and will allow all interested persons to comment on the Company's filing.

ORDER

1. Minnesota Power's Petition for Declaratory Ruling is denied.

2. Minnesota Power's Petition for Variance is approved. The variance will begin with the date of this Order and run for a period of one-year, unless rescinded by Commission action prior to the expiration of the one-year period.

3. Minnesota Power shall file a detailed report, with its monthly fuel adjustment clause filing, describing each sale made under this variance. Minnesota Power shall include details of the terms of the sale agreement, benefits to ratepayers and the Company, and schedules detailing the benefits and accounting mechanisms.

4. Within 45 days from the date of this Order, Minnesota Power shall file with the Commission and the Department of Public Service, and serve copies upon all parties to this docket, a detailed filing showing the impact on the fuel adjustment clause for the sales made prior to the rule variance granted here. The filing shall include detailed schedules calculating the fuel adjustment applying the Company's fuel clause as was authorized at the time of the sales and comparing to schedules showing the fuel adjustment as calculated using the proposed methods. Schedules will also show the total amount which would be refunded to ratepayers should a refund be required. Parties are directed to file comments and recommendations within 45 days from the date of Minnesota Power's filing.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Mary Ellen Hennen
Executive Secretary

(S E A L)